

Decision 05-05-017

May 5, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.

Rulemaking 01-09-001
(Filed September 6, 2001)

Order Instituting Investigation on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.

Investigation 01-09-002
(Filed September 6, 2001)

ORDER DENYING APPLICATION FOR REHEARING
OF DECISION 04-09-061

I. BACKGROUND

D.04-09-061 is an interim opinion concerning Phase 2B audit issues in the New Regulatory Framework (NRF) for the Pacific Bell Telephone Company that has since changed its name to SBC.¹ (R.01-09-001 and I.01-09-002.) By previous decision, we ordered our staff to audit Pacific and by D.04-09-061 we found various audit findings justified and that in some instances Pacific over-reported its expenses. (D.04-09-061 at 1.)² In Phase 2B we examined 68 accounting issues identified by our staff's consultant Overland. A summary of the audit errors is included in Appendix H of D.04-09-061.

¹ The NRF framework was adopted by the Commission in *Re Alternative Regulatory Frameworks for Local Exchange Carriers* (1989) 33 Cal.P.U.C.2d 43 (D.89-10-031) and implemented in 1990. NRF "relaxed regulation of certain large telephone companies in California in exchange for assurances regarding service quality, protection of ratepayer funds, and other measures." (D.04-09-061 at 1.)

² The staff hired a consultant, "Overland," to conduct the audit.

Pacific timely filed an application for rehearing of D.04-09-061 “on the limited ground that the Commission unlawfully ordered SBC California to reimburse the Office of Ratepayer Advocates (“ORA”) for the cost of consultants and technical experts.” (Pacific application for rehearing at 1.) The ORA and The Utility Reform Network (TURN) timely filed responses to the application for rehearing, arguing the Commission is empowered to order a public utility to fund the costs of staff’s audit, including costs expended on consultants and other experts.

We have reviewed each and every allegation of error and find no merit to the allegations.

II. DISCUSSION

Pacific challenges ORA’s status from the start. By arguing that the “Legislature has carefully crafted a mechanism for funding ORA,” Pacific is distinguishing it from the overall agency and essentially arguing that it is or should be treated as if it is, not a part of this agency. Pacific’s differentiation is wrong.

The Commission is a constitutionally created state agency charged with regulating public utilities subject to its jurisdiction. (Cal. Const. Art. XII, § 1, seq.; Pub. Util. Code, §§ 306, 701.) Public Utilities Code section 701 grants the Commission broad powers to carry out its mandate.³ Pacific is a public utility subject to the Commission’s jurisdiction. (Cal. Const. Art. XII, §§ 3, 5; Pub. Util. Code, §§ 216, 234.) The agency is comprised of Commissioners, attorneys, an executive director and such other employees as the executive director deems necessary in order for the Commission to carry out its duties. (Cal. Const. Art. XII, § 1; Pub. Util. Code, §§ 301, 307, 308, 309.) While the Public Utilities Code contemplates a Consumer Services or a Rail Safety Division within the Commission generally for liability purposes associated with any criminal prosecutions that might arise out of investigations by members of such division(s), it mandates the Commission to maintain an Office of Ratepayer Advocates and also a Safety Division. (Pub. Util. Code, §§ 308.5, 309.5, 309.7.) “ORA is an arm of this

³ All statutory references are to the Public Utilities Code unless otherwise indicated.

Commission....” (*Re Application of Citizens Telecommunications Company of California* (2004) ___ Cal.P.U.C.3d ___, D.04-02-010 (2004 Cal.PUCLEXIS 3 *9).)

Pacific contends that D.04-09-061 violates the Public Utilities Code by requiring it to “pay for ORA’s retention of CPAs and technical experts.” Pacific’s argument is premised on an apparent misunderstanding of Pacific’s and the Commission’s regulatory roles, and essentially boils down to a theory that it is being “forced to pay the expenses” of regulatory procedures prescribed by the Legislature and/or Commission rules. Pacific further contends that there is no certainty that it will be reimbursed for costs associated with a staff audit and even if it were, Pacific states, “the Commission does not have the authority to force SBC California to act as ORA’s bank.”

Pacific submits that section 314.5 authorizes the Commission to order an audit,⁴ but argues that section 314.5 is constrained by section 309.5.⁵ Pacific argues that the Legislature has, by section 309.5(f), essentially limited any expenditure by the staff to funds in the Commission’s ratepayer advocate account.⁶ However, section 309.5(f) ensures that the funds in that account are used exclusively by our ORA and that no other Commission divisions have access to it. Contrary to Pacific’s argument, the plain language of section 309.5 does not limit the Commission’s or any of its staff’s funding of the performance of Commission duties exclusively to that account. Further, in addition to the audits required by section 314.5, section 274 grants the Commission discretionary authority to conduct financial audits of public utilities subject to section 270, such as Pacific, whenever it deems such audits necessary. Section 314 empowers the

⁴ Section 314.5 provides: “The commission shall inspect and audit the books and records for regulatory and tax purposes (a) at least once in every three years in the case of every electrical, gas, heat, telegraph, telephone, and water corporation serving over 1,000 customers, and (b) at least once in every five years in the case of every electrical, gas, heat, telegraph, telephone, and water corporation serving 1,000 or fewer customers. An audit conducted in connection with a rate proceeding shall be deemed to fulfill the requirements of this section....”

⁵ Section 309.5 ensures the Commission has at least one division that represents the interests of California utility ratepayers in order to ensure those ratepayers “obtain the lowest possible rate for service consistent with reliable and safe service levels.” (§ 309.5(a).)

⁶ Pacific’s reliance on *Bowland v. Mun. Court for Santa Cruz Judicial Dist.* (1976) 18 Cal.3d 479 (concerning the interpretation of a penal statute), for the proposition that one “cannot interpret a single section of the Public Utilities Code in isolation” is inapposite to its argument concerning section 309.5 since that is precisely what Pacific is attempting to do.

Commission as well as each staff person, “at any time,” to inspect a regulated utility’s accounts, books, papers and documents. While there is no specific code provision regarding funding for these particular duties and powers, section 701 empowers the Commission with broad authority to “do all things” whether set forth in the code or in addition to it “necessary and convenient” to the exercise of our power and jurisdiction. Requiring a regulated utility to fund an audit is within the purview of our authority under section 701.

We recently considered the issues raised by Pacific’s application for rehearing in *Re Application of Citizens Telecommunications Company of California*, *supra* (D.04-02-010). Citizens, doing business as Frontier Communications, was ordered to reimburse the Commission for the costs associated with an audit conducted by the ORA staff, pursuant to section 314.5, the results of which would be used in a Citizens’ NRF. The audit was conducted by consultants under the direct supervision of our ORA staff. Citizens’ complained that the Commission lacks authority to order it to pay for an audit conducted by the ORA’s consultants. In reviewing Citizens’ allegation, D.04-02-010 reviews numerous Commission cases ordering public utilities to provide funding of staff audits, including the costs of consultants. (See e.g., R.01-09-001 and I.01-09-002; D.99-06-051; D.99-02-013; D.96-11-017.) D.04-02-010 is on point to the application for rehearing currently before us since Pacific raises the same issues as Citizens and our discussion in D.04-02-010 is entirely responsive to Pacific’s allegations:

Citizens' main point, regarding who pays for ORA's consultant costs, seems to be that there is no particular code section that specifically allows the Commission to require Citizens to reimburse it for the costs of ORA's consultants to perform the audit. However, there is also no statute that prohibits the Commission from doing so. Citizens claims that the lack of express authority is dispositive. This argument is incorrect. The Commission has plenary powers and broad authority to ensure that its regulatory duties and obligations are carried out and enforced.... (D.04-02-010 (2004 Cal.PUCLEXIS 3 *8).)

There are numerous cases, some of which are referenced above, clarifying our authority to order a public utility to fund consultants needed by staff to conduct an audit ordered by the Commission. Whether the utility recovers those expenses in rates is determined by the reasonableness of the request for rate relief. Thus, where a utility refuses and/or otherwise fails to cooperate in an ordered audit, thereby driving up the costs of the process, it may follow that in a subsequent rate request, the utility's request for reimbursement may be found to be unreasonable.

There have been no changes to the California Constitution or Public Utilities Code since the issuance of D.04-02-010 that diminish our powers and authority to order a public utility to reimburse us for the costs of staff's consultants used in performing an audit of the utility. Like Citizens, Pacific argues that there is no express provision authorizing the Commission to order utilities subject to its jurisdiction to reimburse the costs associated with a staff audit. Again, we specifically addressed this argument in D.04-02-010, stating:

The Commission is required by § 309.5(c) to provide ORA with sufficient resources and personnel to "ensure that customer and subscriber interests are fairly represented in all significant proceedings." The future NRF review will be a significant proceeding, and it is necessary for ORA to conduct an audit to represent ratepayer interests adequately, and for the Commission to have a sufficient record on which to base its decision. As a result, it is necessary to provide ORA with sufficient resources to hire consultants to do the audit in order to comply with § 309.5(c).

... [T]he Commission has taken this approach in the past, and it is by no means novel or unusual. We are mindful of our past decisions, and do not believe Citizens' arguments present a good reason to deviate from this longstanding practice, especially since the performance of the audit allows the Commission to comply with a number of statutory mandates. In this case, § 701 provides that the Commission "may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction." We believe this means that the Commission should use its authority to

ensure that its regulatory duties and obligations are carried out and enforced.

Contrary to Citizens' assertions, it is well established that the Commission's powers are not limited to those expressly conferred upon it. Section 701 grants the Commission authority to "do all things", including those "in addition" to those set forth in the Public Utilities Act, so long as it does not contravene an express legislative directive or take action that is not cognate or germane to utilities regulation. [Citations omitted.] This decision relates to the financial information the Commission will use in a future rate proceeding, and addresses the funding of an audit to be undertaken by Commission staff ORA is not an outside party; it is an arm of the Commission. (§ 309.5.) Specific legislation addressing the way the Commission conducts certain public purpose programs, or reviews construction costs or environmental impacts, does not define the scope of the Commission's authority here. (D.04-02-010 (2004 Cal.PUCLEXIS 3 *10-*11).)

Finally, also like Citizens, Pacific argues that it is not guaranteed recovery of the costs of funding the audit through rates. The Commission is required by sections 451 and 453 to ensure that rates are just and reasonable, and are not the result of prejudice or disadvantage of any person or corporation, which could arguably be the case if a utility unreasonably fails to cooperate with an audit thereby driving up the costs, since in behaving unreasonably and increasing litigation and/or related costs a utility may be disadvantaging persons and corporations that are its ratepayers. In D.04-02-010 the Commission permitted Citizens to seek to recoup the costs of the audit in rates if it reasonably cooperates with the audit. (D.04-02-010 (2004 Cal.PUCLEXIS 3 *12).)

Because Pacific is not guaranteed recovery of the costs, it contends its due process and equal protection rights are violated, citing *Cossack v. Los Angeles* (1974) 11 Cal.3d 726, 734. In *Cossack, supra*, plaintiffs sought to operate a type of pin-ball business that fell within a criminal ordinance concerning gambling, although the ordinance was preempted by a state law because the business was considered to be a game of skill rather than one of chance. The court noted that even if the business did fall within the ordinance it would have been unconstitutional under the equal protection

clauses of the federal and state constitutions because there would have been an arbitrary discrimination against the limited number of games of skill that would have fallen within the ordinance. (11 Cal.3d at 734.)

Cossack, supra, is off point here, not only because the specific subject matter is not relevant but additionally because there is nothing unreasonable about the Commission requiring utilities subject to its regulation to fund audits required for regulatory purposes, and it is a usual Commission practice. Requiring Pacific to fund the audit is no different than requiring another public utility to fund an audit the Commission determines is necessary to its regulation. Further, it would be unreasonable, arbitrary and capricious for the Commission to permit the utility to completely recover the costs of the audit in rates prior to a finding, based on record evidence, that the costs are reasonable. Indeed, contrary to Pacific's contention that section 309.5 limits the Commission's authority to order public utilities to fund staff audits, the case of *Sales v. Agric. Labor Relations Bd.* (1985) 39 Cal.3rd 209, 223, relying on *Cossack, supra*, 11 Cal.3d at 734, establishes that:

It is a cardinal rule of statutory construction that statutory language "must be given such interpretation as will promote rather than defeat the general purpose and policy of the law." [Citation.] This, in turn, requires us to "take into account matters such as context, the object in view, the evils to be remedied, the history of the times and of legislation upon the same subject, public policy, and contemporaneous construction." [Citation omitted.] (39 Cal.3rd at 223.)

The Commission's interpretation of the Public Utilities Code "should not be disturbed unless it fails to bear a reasonable relation to statutory purposes and language...." (*Southern California Edison v. Peevey* (2003) 31 Cal.4th 781, 796, citing *Greyhound Lines, Inc. v. Public Utilities Com.* (1968) 68 Cal.2d 406, 410-411.) The primary purpose of the Commission is to regulate public utilities and auditing public utilities is but one means by which the Commission fulfills its duties and responsibilities. Ordering public utilities to fund necessary audits is entirely within the Commission's

power, as is the determination, subject to the requirements of the Code, of whether a utility should be permitted to ultimately recover the costs of an audit from its ratepayers. Pacific has not shown that Commission's interpretation of its authority for ordering Pacific to fund the audit consultant costs is erroneous, and its allegations are entirely without merit.

III. CONCLUSION

We have carefully considered all of the arguments presented by Pacific and are of the opinion that good cause for rehearing has not been shown. Accordingly, we deny Pacific's application for rehearing of D.04-09-061.

Therefore, **IT IS ORDERED** that:

1. The application for rehearing of Decision 04-09-061 is denied.

This order is effective today.

Dated May 5, 2005 at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
Commissioners

Commissioner Susan P. Kennedy, being
necessarily absent, did not participate.

I abstain.

/s/ JOHN A. BOHN
Commissioner